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Editorial: Economy requires long-term and short-term fixes
Both quick stimulus, financial reforms are needed to deal with current downturn

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With the mortgage crisis sending shock waves through the economy, we're seeing the perils of rigid adherence to unregulated markets. We're also getting a reminder of the need for a public safety net in bad times.

California, once again, foreshadows what's to come nationally. Foreclosures and default notices are at record highs. Unemployment is up and consumer spending is down. People are having trouble paying their bills.

So how did we get here? The simple answer is that in a deregulated marketplace, banks and mortgage companies made loans to borrowers without verifying their ability to pay. The lenders sold these loans to other companies, which bundled them with other loans and created newfangled investments for buyers around the world. With many of these loans now failing, banks, mortgage companies and investors are writing off hundreds of billions in losses.

And since borrowers used their homes to take out yet more loans to buy cars, appliances, computers, TVs, and other goods, consumer spending also is drying up.

As a result, we're seeing the beginning of a long, hard reckoning – worse than the dot-com bust of 2001. As an analyst at Lehman Brothers put it, we're going to see "slow-moving shocks, a series of body blows that keep coming one after another, rather than a knock-out punch."

The Federal Reserve under the new leadership of Ben Bernanke is doing its part to help businesses and households get access to money. On Tuesday, the Fed called an emergency meeting and made the biggest single cut in interest rates in its history. Why? It believes "broader financial market conditions have continued to deteriorate." And things are going to get worse: "Incoming information indicates a deepening of the housing contraction as well as some softening in labor markets." Tuesday's action follows the Fed's creative credit auction in December to put more money into the banking system. But the central bank alone cannot reverse the economic downturn.

The current mess will require experimentation on the scale of President Franklin D. Roosevelt in the 1930s.

In the short term, that means getting money into people's hands quickly to sustain purchasing power – a temporary stimulus package. Bush and Congress are looking at a boost of $140 billion or more (roughly 1 percent of the $14 trillion economy): extending unemployment insurance benefits beyond 26 weeks; providing relief to states (which are cutting health coverage and assistance to the needy to balance budgets); accelerating infrastructure projects that can get under way within 90 days; increasing food stamp payments; giving a tax rebate to everyone who works and pays Social Security taxes.

In the long term, it means structural reform of the financial sector to restore confidence, transparency and stability – that is, regulating the new financial entities and financial products that produced this mess. It means rethinking the U.S. safety net – pensions, health coverage and unemployment relief – for a new generation.

No one can predict the road ahead, but one thing is clear: Whoever wins the presidential election will have to pay much more attention to the economy – and rewrite the "unfettered markets" script of the last decade.